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Legend

Trust =

State =

City X =

City Y =

City Z =

Year 1 =

Year 2 =

Month =

Date =

a =

b =

c =

d =

Dear _____ :

This responds to a letter, dated August 24, 2010, submitted on behalf of Trust. Trust requests rulings under section 856(c) of the Internal Revenue Code (Code).

FACTS

Trust is a publicly-traded REIT that manages a diversified portfolio of real estate properties comprising office, industrial, and service-oriented properties primarily in the City X metropolitan area. Trust has elected to be treated as a REIT beginning with its Year 2 taxable year.

In Month, Year 2, Trust brought a claim for just compensation for a acres of its properties in City Y and City Z in State (collectively, "Property"), which Property was taken by State in Year 1. State paid Trust \$b (Initial Amount) for Property at the time of the taking. Trust elected, under the eminent domain law of State, to treat the Initial Amount as an advance payment while it pursued its claim. Trust invested the Initial Amount into real estate.

On Date, the Court of Claims of State (Court) issued an opinion requiring State to pay Trust an additional \$c (Additional Amount) for Property taken from Trust by State in Year 1. Under a provision of the eminent domain law of State, Trust is entitled to statutory simple interest on the Additional Amount at a rate not to exceed d% per annum from the date of the taking until the date of payment (Interest).

Court, in its opinion, agreed State improperly valued Property and misapplied the requirement of the eminent domain law of State that just compensation be determined based upon the highest and best use and the probability that such use could have been achieved. Applying this standard, Court determined that there was a reasonable probability Property would have been rezoned from light industrial use to a planned development district, thereby resulting in the Additional Amount awarded Trust.

Trust sought and was awarded reimbursement of attorney's fees and costs (Costs). "Claim" is the Initial Amount, Additional Amount, Interest, and Costs. As of the date of its ruling request, neither the amount of Claim nor the timing of its payment were known. Trust represents that, in accordance with generally accepted accounting principles (GAAP), Trust had not yet reported Claim as part of its total assets on its financial statement.

LAW AND ANALYSIS

Section 856(c)(2) provides that at least 95 percent of a REIT's gross income (excluding gross income from prohibited transactions) must be derived from dividends, interest, rents from real property, gain from the sale or other disposition of stock, securities, and real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1), and certain other sources.

Section 856(c)(3) provides that at least 75 percent of a REIT's gross income (excluding gross income from prohibited transactions) must be derived from rents from real property, interest on obligations secured by mortgages on real property or on interests in real property, gain from the sale or other disposition of real property (including interests in real property and interests in mortgages on real property) which is not property described in section 1221(a)(1), and certain other sources.

Section 856(c)(4)(A) provides that at the close of each quarter of its tax year, at least 75 percent of the value of a REIT's total assets must be represented by real estate assets, cash and cash items (including receivables), and Government securities.

Section 856(c)(5)(B) of the Code and section 1.856-3(b) of the Income Tax Regulations (Regulations) defines the term "real estate assets," in part, to mean real property (including interests in real property and interests in mortgages on real property) and shares (or transferable certificates of beneficial interest) in other REITs that meet the requirements of sections 856 through 859.

Section 856(c)(5)(C) and section 1.856-3(c) of the Regulations provides that the term "interests in real property" includes fee ownership and co-ownership of land or improvements thereon, leaseholds of land or improvements thereon, options to acquire land or improvements thereon, and options to acquire leaseholds of land or improvements thereon, but does not include mineral, oil or gas royalty interests.

Section 1.856-2(d)(3) of the Regulations provides that in determining the investment status of a REIT, the term "total assets" means the gross assets of the REIT determined in accordance with GAAP.

Section 1.856-3(d) provides that "real property" includes land or improvements thereon, such as buildings or other inherently permanent structures thereon (including items which are structural components of such buildings or structures). In addition, the term "real property" includes interests in real property. Local law definitions will not be controlling for purposes of determining the meaning of "real property" for purposes of section 856 and the regulations thereunder.

Section 856(d)(1) provides that for purposes of sections 856(c)(2) and (3), the term “rents from real property” includes rents from interests in real property, charges for services customarily furnished or rendered in connection with the rental of real property, whether or not such charges are separately stated, and certain rents attributable to personal property. Section 1.856-4 of the Regulations provides that the term “rents from real property” generally means the gross amount received for the use of, or the right to use, real property of the REIT. Section 856(d)(2) of the Code and section 1.856-4(b)(3)-(6) of the Regulations provide certain exclusions to the term “rents from real property,” including in part, amounts received or accrued, directly or indirectly, with respect to any real or personal property, if the determination of such amount depends in whole or in part on the income or profits derived by any person from such property.

Section 856(c)(5)(J), which was added to the Code by Division C of the Housing and Economic Recovery Act of 2008, P.L. 110-289, provides, inter alia, that to the extent necessary to carry out the purposes of part II of subchapter M, the Secretary of the Treasury is authorized to determine, solely for purposes of this part, whether any item of income or gain that does not qualify under section 856(c)(2) or section 856(c)(3) to satisfy the 95 percent and 75 percent REIT gross income tests, may be considered as not constituting gross income for purposes of section 856(c)(2) or section 856(c)(3).

The staff of the Joint Committee on Taxation in its General Explanation of the Tax Legislation Enacted in the 110th Congress describes section 856(c)(5)(J) as follows: “The provision authorizes the Treasury Department to issue guidance that would allow other items of income to be excluded for purposes of the computation of qualifying gross income under either the 75 percent or the 95 percent test, respectively, or to be included as qualifying income for either of such tests, respectively, in appropriate cases consistent with the purposes of the REIT provisions.” Footnote 309 of the General Explanation provides that income that is statutorily excluded from gross income computations under the provision is not intended to be within the authority to include as qualifying income. Joint Committee on Taxation Staff, General Explanation of the Tax Legislation Enacted in the 110th Congress, 110 Cong., 2d Sess. (2009), 239.

The legislative history underlying the REIT asset test in section 856(c)(4) indicates that the test “is designed to give assurance that the bulk of the trust’s investments are in real estate.” H.R. Rep. No. 2020, 86th Cong., 2d Sess. 4 (1960) at 6, 1960-2 C.B. 819, 822. The legislative history also indicates that Congress intended to provide REITs with tax treatment similar to the treatment accorded regulated investment companies (RICs).

In Rev. Rul. 64-247, 1964-2 C.B. 179, a RIC recovered excess management fees from its investment manager. The recovery was made as a result of legal action brought against the company’s former officers and directors who had owned the investment manager. In Rev. Rul. 74-248, 1974-1 C.B. 167, a RIC’s former investment advisor paid the company an amount the advisor had improperly received for assigning

its advisory contract. The payment was made pursuant to a settlement agreement that was reached after the company's shareholders filed a derivative action against the investment advisor. In both rulings, the amounts in question were includible in the RIC's gross income under section 61 of the Code. Those amounts were not, however, income from sources that, at the time the rulings were published, were described in section 851(b)(2) of the Code. The rulings hold, nevertheless, that the companies' inclusion of the amounts in gross income did not cause the companies to fail to meet the definition of a RIC contained in section 851, provided the companies in all other respects qualified for RIC status for the tax year in question.

Rev. Rul. 64-247 and Rev. Rul. 74-248 were rendered obsolete, in part, for purposes of section 851 by Rev. Rul. 92-56, 1992-2 C.B. 153, which holds that if, in the normal course of its business, a RIC receives a reimbursement from its investment advisor and the reimbursement is included in the RIC's gross income, the reimbursement is qualifying income under section 851(b)(2). However, the prior revenue rulings remain instructive in determining how certain payments may be treated for RIC or REIT qualification purposes when the payment is not specifically described by the governing statute or underlying regulations.

Under the facts of this case, Fund's Claim is not specifically described by applicable Code or Regulations. However, Trust represents it engaged in no active business activity to create Claim, and that Claim is the amount paid or to be paid Trust for Property (real estate taken from Trust by State in Year 1) after Court makes a final determination of what is a fair price for such real property. Trust also represents it has invested the Initial Amount (that portion of Claim Trust received from State at the time of the taking of Property) into real property and plans to invest any further payments it will receive from State with respect to Claim into "real estate assets" as defined in section 856(c)(4). Public policy underlying the eminent domain law of State, which requires, under the facts of this case, State pay Trust just compensation for Property taken from Trust, in Year 1, does not interfere with or impede the policy objectives of Congress in enacting the REIT qualification tests under section 856(c). Moreover, there is nothing in the legislative history or any statutory interpretation that would indicate that by imposing parameters on the sources from which REITs and RICs may derive income, Congress intended to discourage REITs and RICs from pursuing legal remedies from which damages may be collected.

Based on the information submitted and the representations made, we rule that (i) Claim will not be considered in determining whether Trust satisfies the REIT asset tests under section 856(c)(4), and (ii) under section 856(c)(5)(J), the Interest and Costs Trust derives from Claim will not be considered in determining whether Trust satisfies the REIT gross income tests under sections 856(c)(2) and 856(c)(3).

This ruling's application is limited to the facts, representations, Code sections, and regulations cited herein. No opinion is expressed with regard to whether Trust otherwise qualifies as a REIT under subchapter M of the Code.

This ruling is directed only to the taxpayer requesting it. Section 6110(k)(3) of the Code provides that it may not be used or cited as precedent.

In accordance with the Power of Attorney on file with this office, a copy of this letter is being sent to your authorized representatives.

Sincerely,

Alice M. Bennett
Branch Chief, Branch 3
Office of Associate Chief Counsel
(Financial Institutions & Products)

Enclosures:

Copy of this letter
Copy for § 6110 purposes

cc: